

SAE 3400 - "The Examination of prospective financial information"

- Examination & report on PFI including procedures for best-estimate and hypothetical assumptions.
- Examination of PFI **need not necessarily be performed by statutory auditor** of entity's F.s.

Prospective Financial Information (PFI)

PFI is Financial info. based on **Assumptions** about events that may occur in future & **Possible actions** by entity. (**highly subjective** in nature). PFI can be in form of Forecast **OR** Projection **OR** Both

Forecast
PFI prepared on basis of **Assumptions** as to future events and **actions** mgt. expects to take. (**Best Estimate Assumptions** - anticipated experience with **no provision for risk of adverse deviation**.) (5% sales increase)

Projection
PFI prepared on the basis of:

- Hypothetical assumptions** about future events and mgt. actions ---> which are **not necessarily expected to take place**, (when entities are in start-up phase or are considering change in operations)
- A **mixture of best-estimate & hypothetical assumptions** (imagined or suggested)
Ex - (creating new product | setting up plant | cash flows projection for 7 yr.)

Scope of SAE-3400

This SAE **does not apply to**

- Examination of PFI **in general** or narrative terms, such as mgt.'s discussion & analysis in annual report,
- Principles in other SAs, should be used.**

Responsibility of Preparation of PFI

Mgt. is responsible for preparation and presentation of PFI including:

- Identification & disclosure** of PFI;
- Explaining **BASIS of forecast**;
- Underlying **assumptions**

Term "Auditor" is used throughout this SAE is **NOT intended** to imply statutory auditor

Nature of assurance regarding PFI - It Relates to events & actions **not yet occurred & may not occur**. **Evidence is itself generally future-oriented**. Therefore, **opinion cannot be expressed**

Can Professional Accountants be associated with PFI?

Clause 3 of the Second Schedule to CAs Act, 1949 states that that ---> A **CA in practice** shall be deemed to be **guilty of professional misconduct** ---> if he permits his **name** or name of his firm to be **used** in connection with an estimate of earnings contingent upon future transactions **in a manner** which may **lead to belief that he vouches for ACCURACY of forecast**.

Above clause **does not preclude** a CA from associating his name with Prospective F.s.

- A CA **can participate** in the **preparation** of profit or financial **FORECASTS** and can **review** them, provided he indicates clearly **sources** of info., **basis** of forecasts and also major **assumptions** made & so long as he **does not vouch for accuracy** of forecasts.
- The same also applies to **PROJECTIONS** made on the basis of hypothetical assumptions

Duties of Member who is Examining the PFI

Auditor should obtain SAAE as to whether:

- Mgt.'s **Best - Estimate Assumptions** on which PFI is based are **not unreasonable** and **Hypothetical Assumptions**, are **consistent with purpose** of info.
- PFI is **properly prepared** on basis of assumptions;
- PFI is **properly presented** & **all material assumptions** are **adequately disclosed**, (indicating whether **Best-Estimate Assumption OR hypothetical Assumption**)

Precautions Before Accepting Engagement

Before accepting auditor would **consider**:

- Intended use** of information;
- Whether info. will be for **General or Limited distribution**;
- Nature of assumptions**, - Best estimates or Hypothetical;
- Elements** to be included in information;
- Period covered** by information.

Further, Auditor **should not accept, OR should withdraw** from, engagement -> when **assumptions are unrealistic OR** when PFI will be **inappropriate for its**

4. PFI is prepared on a consistent basis with historic F.s, using appropriate a/c principle	intended use. Consider to which extent reliance on entity's historical financial information is justified.
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Determining NTE of examination procedures	Assessing Presentation & Disclosure
<ol style="list-style-type: none"> 1. Knowledge obtained during previous engagements 2. Mgt.'s competence regarding preparation of PFI 3. The Likelihood of material misstatement 4. Extent to which PFI is affected by mgt.'s judgment 5. Sources of info. considered by mgt. their adequacy, reliability of underlying data, 6. Stability of entity's business and 7. Engagement team's experience with business and industry in which entity operates 	<p>Consider whether: -</p> <ol style="list-style-type: none"> 1. Presentation of PFI is informative & not misleading 2. A/c policies are clearly disclosed in notes 3. Assumptions are adequately disclosed (whether, best-estimates OR hypothetical) when assumptions are subject to high degree of uncertainty, --> uncertainty & resulting sensitivity of results) 4. Date as of which PFI was prepared, Mgt. confirms that assumptions are appropriate as of this date 5. Basis of establishing points in a range is clearly indicated and range is not selected in biased or misleading manner 6. If there is any change in a/c policy of entity from that disclosed in most recent historical F.s, (whether reason & effect of such change adequately disclosed)

Report on Examination of PFI	Such a report would
<ol style="list-style-type: none"> a. Title b. Addressee c. Identification of PFI d. Reference to SAEs applicable e. Statement that mgt. is responsible for PFI including underlying assumptions f. Reference to purpose and/or restricted distribution of PFI g. Statement that examination procedures are of evidence supporting assumptions, amt.s & other disclosures in forecast or projection h. Statement of negative assurance, whether assumptions are a reasonable basis for PFI. i. Opinion, whether PFI is properly prepared on basis of assumptions & presented as per FRF j. Appropriate caveats concerning achievability of results of PFI (*caveats - warning) k. Date of report (date procedures completed) l. Place of signature and m. Signature. 	<ol style="list-style-type: none"> 1. State whether, anything has come to attention, that assumptions do not provide a reasonable basis for PFI. 2. Express an opinion as to whether PFI is properly prepared on basis of assumptions, and presented as per FRF. 3. State that: - <ul style="list-style-type: none"> o Actual results are likely to be different from PFI & variation could be material. o When PFI is expressed as a range, state that no assurance that actual results will fall within range o In case of projection, PFI has been prepared for (intended use), using hypothetical assumptions about future events and mgt.'s actions that not necessarily occur. Consequently, readers are cautioned that PFI should not be used for purposes other than mentioned.

Modification or Withdrawal
When presentation & disclosure of PFI is not adequate ----> Qualified OR Adverse opinion OR withdrawal from engagement should be made.
If assumptions do not provide reasonable basis for PFI ----> Adverse opinion OR Withdrawal
When examination is affected by conditions that preclude application of one or more procedures considered necessary in the circumstances ----> Withdrawal OR Disclaimer of opinion & describing the scope limitation in report.

SAE 3402 - "Assurance Reports on Controls at a Service Organisation"

Introduction

- SAE 3402 deals with assurance engagements undertaken by a professional accountant in practice to provide a report for use by User entities & their auditors on controls at service organization.
- It complements SA 402, in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.

Scope of SAE 3402	Objectives of Service Auditor as per SAE 3402
<p>SAE 3402 applies only when SO is responsible for design of controls & does not deal with assurance engagements:</p> <ol style="list-style-type: none"> To report only on whether controls at SO operated as described or To report only on controls at SO other than those related to SO that is likely to be relevant to user entities' I.C for financial reporting (ex: controls that affect user entities' production or quality) 	<ol style="list-style-type: none"> To obtain reasonable assurance about whether: <ul style="list-style-type: none"> Service organization's description of its system fairly presents the system as designed and implemented throughout the specified period specified date (in case of type 1 report) Controls related to control objectives stated in service organization's description of its system were suitably designed throughout specified period specified date (in case of type 1 report) Where included in scope, controls operated effectively to provide reasonable assurance that control objectives were achieved throughout specified period. To report as per service auditor's findings.

Why controls of SO are important to a user entity's internal controls relating to financial reporting?

As it relates to financial reporting. Such controls may pertain to assertions about presentation & disclosure relating to a/c bal., classes of txns, or disclosures, OR may pertain to evidence that user auditor uses in applying auditing procedures.

Ex: A co. has outsourced its payroll processing functions. Service organization is responsible for accurate preparation of payrolls & timely remittance of statutory dues to govt. authorities.

Payroll processing SO's controls related to timely remittance of payroll deductions to govt. authorities is relevant to co. (user entity) as late remittances could result in penalties for user entity.

Whether controls at a SO are relevant to user entities' I.C as it relates to financial reporting ---> is a matter of judgment, having regard to control objectives set by SO & suitability of criteria.

Type 1 Report & Type 2 Report

Type 1 report is a report that comprises:	Type 2 report is a report that comprises:
Service org.'s description of its system;	Service organization's description of its system
<p>Written assertion by SO that:</p> <ol style="list-style-type: none"> Description fairly presents SO's system as designed & implemented at specified date Controls, for control objectives in SO's description of its system, were suitably designed as at specified date 	<p>Written assertion by SO that:</p> <ol style="list-style-type: none"> Description fairly presents SO's system as designed & implemented throughout specified period Controls, for control objectives in SO's description of its system, were suitably designed, throughout specified period Controls, in SO's description of its system, operated effectively throughout specified period
<p>Service auditor's assurance report that</p> <ol style="list-style-type: none"> conveys reasonable assurance about matters referred to in (ii) 	<p>Service auditor's assurance report that:</p> <ol style="list-style-type: none"> Conveys reasonable assurance about matters referred in (ii) &

b. Includes a **description of TOC** & results thereof.

How such an Engagement is Proceeded ? / Procedures performed by Service Auditor

1. **Compliance with ethical requirements:** Comply with ethical requirements, including independence
2. **Determination of Mgt. & TCWG & communication with them**
3. **Acceptance & changes in terms of engagement:** Before, accepting engagement, **ensured that service auditor** has **capabilities & competence**. | **Criteria applied by SO** is **suitable** | **Scope** of engagement is **not so limited that** --> they are **unlikely to be useful to user entities** & their auditors. | If **SO requests a change in scope**, there is a **reasonable justification** for change.
4. **Assessing of suitability of the Criteria:** Assess **whether SO has used suitable criteria** in preparing description of its system, in evaluating whether controls are suitably designed, & in Type 2 Reports **controls are Operating effectively**.
5. **Determination of Materiality.**
6. **Obtaining an understanding of Service organization's system:** **Including controls**
7. **Obtaining evidence regarding the description:** **Read SO's description of its system and evaluate whether it is fairly presented.**
8. **Obtaining evidence regarding design of controls:** **Determine which controls at SO are necessary & assess whether those were suitably designed.**
9. **Obtaining evidence regarding operating effectiveness of controls:** **When providing a type 2 report, test those controls & assess their operating effectiveness throughout period.**
10. **Understanding internal audit function:** **Understand responsibilities of internal audit function and determine whether service auditor can use specific work of internal auditors.**
11. **Asking for Written Representation from SO -**

- | | |
|---|--|
| <ul style="list-style-type: none"> ▪ Reaffirm the assertion accompanying description of system ▪ That it has provided the service auditor with all relevant info. and access ▪ That it has disclosed to service auditor any of the following of which it is aware:- <table border="1" style="margin-left: 20px;"> <tr> <td> <ul style="list-style-type: none"> ✓ Non-compliance with L&R, fraud, in SO that may affect user entity ✓ Design deficiencies in controls ✓ Instances where controls have not operated as described and ✓ Any subsequent events having significant effect on service auditor's assurance report </td> </tr> </table> | <ul style="list-style-type: none"> ✓ Non-compliance with L&R, fraud, in SO that may affect user entity ✓ Design deficiencies in controls ✓ Instances where controls have not operated as described and ✓ Any subsequent events having significant effect on service auditor's assurance report |
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Reporting / Elements to be included in service auditor's assurance report

1	Title - Independent service auditor's assurance report.
2	Addressee
3	Identification of: - <ol style="list-style-type: none"> 1. SO's description of its system, and assertions, which the matters for type 1 or Type 2 report 2. Parts of SO's system description not covered by service auditor's opinion. 3. If description refers to need for complementary user entity controls, A statement that service auditor has not evaluated complementary user entity controls, & that control objectives can be achieved, if complementary controls are designed & operating effectively. 4. If services are performed by Sub-SO, nature of activities performed by Sub-SO
4	Identification of criteria , and party specifying control objectives.
5	Statement that --> the report & in case of type 2 report, description of TOC are intended only for user entities & their auditors
6	Statement that service organization is responsible for: - <ol style="list-style-type: none"> 1. Preparing description of system, & assertion, including completeness, accuracy 2. Providing the services covered by SO's description of its system; 3. Stating control objectives 4. Designing and implementing controls to achieve the control objectives

7	Statement that --> service auditor's responsibility is to express an opinion on SO's description, design of controls and, in case of type 2 report, on operating effectiveness of controls.								
8	Statement that --> Engagement was performed as per SAE 3402								
9	A summary of service auditor's procedures to obtain reasonable assurance and A statement --> evidence obtained is sufficient & appropriate & In case of type 1 report, A statement --> he has not performed any procedures for operating effectiveness of controls								
10	Statement of limitations of controls &, For type 2 report, of risk of projecting to future periods any evaluation of operating effectiveness of controls.								
11	Opinion, expressed in positive form: <table border="1" data-bbox="172 521 1485 775"> <thead> <tr> <th>Type 2 Report</th> <th>Type 1 Report</th> </tr> </thead> <tbody> <tr> <td>The description, fairly presents SO's system that had been designed & implemented throughout the specified period</td> <td>as at specified date</td> </tr> <tr> <td>Controls related to control objectives stated in SO's description of its system were suitably designed throughout the specified period; and</td> <td>as at specified date</td> </tr> <tr> <td>Controls tested, operated effectively throughout the specified period</td> <td>----xxx----</td> </tr> </tbody> </table>	Type 2 Report	Type 1 Report	The description, fairly presents SO's system that had been designed & implemented throughout the specified period	as at specified date	Controls related to control objectives stated in SO's description of its system were suitably designed throughout the specified period; and	as at specified date	Controls tested, operated effectively throughout the specified period	----xxx----
Type 2 Report	Type 1 Report								
The description, fairly presents SO's system that had been designed & implemented throughout the specified period	as at specified date								
Controls related to control objectives stated in SO's description of its system were suitably designed throughout the specified period; and	as at specified date								
Controls tested, operated effectively throughout the specified period	----xxx----								
12	Date of service auditor's assurance report.								
13	Signature.								
14	Place of signature (city where report is signed)								

Additional matters requiring reporting in type 2 report

Description of TOC	<ul style="list-style-type: none"> Separate section after opinion, that describes Test of controls that were performed & results of those tests. State which controls were tested, identify whether items tested represent all or a selection of items in population, & indicate nature of tests.
Deviations identified & reported	<ul style="list-style-type: none"> If deviations have been identified, include extent of testing performed (sample size), and no. & nature of deviations noted. Report deviations even if, control objective was achieved.

Modified Opinions

<ol style="list-style-type: none"> SO's description does not fairly present, system as designed & implemented; Controls related to control objectives were not suitably designed In type 2 report, controls tested, , did not operate effectively Service auditor is unable to obtain sufficient appropriate evidence, <p>Opinion shall be modified, & report shall contain a description of reasons for modification.</p>
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Documentation

Sufficient for an experienced auditor, having no previous connection with engagement, to understand		
NTE of procedures performed to comply with SAE & L&R requirements	Results of procedures performed, & evidence obtained	Significant matters arising during engagement, conclusions reached & judgments made

SAE 3420 - "Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus"

SA 3420 deals with reasonable assurance engagements to report on compilation of pro forma financial information (PFFI) included in a prospectus. It applies where such reporting is required by securities law or regulation, in which prospectus is to be issued

What is Pro forma financial information?

Meaning	PFFI refers to financial info. shown with adjustments to illustrate impact of transaction on unadjusted financial information as if txn. had been undertaken at an earlier date.
Use	PFFI is, normally, used in offer documents to demonstrate effect of a transaction on F.s of a co. as if those txns. had occurred at an earlier date
Format	May take form of Statement of P&L and B/s, also include notes
Purpose	Sole Purpose is to illustrate impact of a significant event or txn. on unadjusted financial info. as if txn. had been undertaken at an earlier date for purposes of illustration. ✚ Achieved by applying pro forma adjustments to the unadjusted financial information. ✚ PFFI does NOT represent entity's ACTUAL financial position

Compilation of Pro forma financial information

Involves responsible party gathering, classifying, summarising & presenting financial info.

Steps involved in this process include	Practitioner's Responsibility
<ol style="list-style-type: none"> 1. Identifying SOURCE of unadjusted financial info. to be used in compiling PFFI, and extracting unadjusted financial information from that source 2. Making PRO FORMA ADJUSTMENTS to the unadjusted financial information 3. Presenting resulting PFFI with disclosures. 	Practitioner has NO responsibility to compile PFFI for entity. Such responsibility rests with responsible party (mgt.). Practitioner's sole responsibility is to report on whether PFFI has been compiled, by responsible party ---> on basis of applicable criteria. [Reasonable assurance engagement, to assess whether applicable criteria provide a reasonable basis]

Steps involved in such an Engagement

Engagement acceptance ---> Planning & performing engagement ---> Written Representations →
Forming the opinion ---> Preparing the assurance report.

Engagement Acceptance
Before accepting engagement on whether PFFI been compiled, on basis of applicable criteria consider.
<ol style="list-style-type: none"> 1. Determine that practitioner has capabilities & competence to perform engagement 2. On the basis of preliminary knowledge & discussion with responsible party, determine that applicable criteria are suitable and it is unlikely that PFFI will be misleading 3. Evaluate wording of opinion prescribed by law to determine if practitioner will likely be able to express opinion based on procedures specified in this SAE 4. Where unadjusted financial information have been audited and MODIFIED opinion expressed, or report contains an EOM para ---> consider whether or not law permits reference 5. If entity's (*acquirer) historical financial info. has never been audited ---> consider whether practitioner can obtain a sufficient understanding to perform engagement 6. Obtain agreement of responsible party that it acknowledges & understands its responsibility
Agreement of Responsible Party that it acknowledges & understands its responsibility
<ol style="list-style-type: none"> 1. Adequately disclosing the applicable criteria to users 2. Compiling PFFI on basis of applicable criteria and 3. Providing the practitioner with:-

- **Access to all info.** (including, info. of acquiree in a business combination), when needed, relevant to evaluate whether PFFI has been compiled, on basis of applicable criteria
- **Additional information** that practitioner may request
- **Unrestricted Access to those within the entity (*acquirer)** from whom practitioner determines it **necessary to obtain evidence (acquiree also, If needed)**

***Applicable criteria** - Criteria used when compiling PFFI. (Established by recognized standard-setting organization or by law. Where no established criteria, developed by responsible party)

In Planning and Performing Engagement, Practitioner shall:-

1. Assess whether **applicable criteria** are **suitable**.
2. **Consider materiality** for evaluating whether PFFI is compiled, on basis of applicable criteria.
3. Obtain **understanding** of how **responsible party has compiled** PFFI and other engagement
4. Obtain **evidence about appropriateness of source** from which unadjusted info. has been extracted
5. If **no audit or review on source**, perform procedures to be **satisfied that source is appropriate**.
6. Determine **whether** client has **appropriately extracted** unadjusted financial info. from source.
7. Obtain **evidence about appropriateness of the pro forma adjustments**.

In relation to unadjusted financial information, **Pro forma adjustments include:**

Adjustments to unadjusted financial info. that illustrate impact of a significant event or txn. as if it had occurred at an earlier date	Adjustments to unadjusted financial info. that are necessary for PFFI to be compiled on a basis consistent with AFRF & a/c policies .
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8. **Evaluate presentation** of PFFI.
9. **Read other information** included in the Prospectus to **identify material inconsistencies**, with PFFI.

Written Representations	Request written representations :- Responsible party has identified all appropriate pro forma adjustments PFFI has been compiled , on basis of applicable criteria.
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Opinion/ Forming the opinion

Unmodified Opinion	Express an unmodified opinion when practitioner concludes that PFFI has been compiled, in all material respects , by responsible party on basis of applicable criteria .
Modified Opinion	<ul style="list-style-type: none"> ▪ Where Law/Regulation PRECLUDES (prohibits) publication of a prospectus containing modified opinion & Practitioner concludes that a modified opinion is, appropriate he shall discuss the matter with responsible party. ▪ If responsible party does not agrees to make necessary changes, practitioner shall: Withdraw from engagement OR Consider seeking legal advice. ▪ Where Law/Regulation may NOT PRECLUDE publication of a prospectus containing modified opinion he shall issue modified opinion.
EOM Para	When practitioner considers it necessary to draw user's attention to a matter disclosed in PFFI that it is fundamental to user's understanding . He shall include an EOM para . Such a para shall refer only to info. presented or disclosed in PFFI.

Preparing the assurance report / Basic elements of assurance report

1	Title that clearly indicates that report is an independent assurance report
2	Addressee
3	Introductory para that identify PFFI, Source from which unadjusted financial info. has been extracted, Period covered or date of PFFI, Reference to applicable criteria on basis of which responsible party has performed compilation of PFFI, and source of criteria
4	Statement that responsible party is responsible for compiling PFFI on basis of applicable criteria
5	Description of practitioner's responsibilities , including statements that: -

	<ul style="list-style-type: none"> Practitioner's responsibility is to express an opinion about whether PFFI has been compiled, in all material respects, on basis of applicable criteria Practitioner is not responsible for updating or reissuing any reports or opinions on any historical financial info. used in compiling PFFI, nor has he performed an audit or review He does NOT provide any assurance that actual outcome at that date would be as presented
6	Statement that engagement was performed in accordance with SAE 3420
7	Statements that: - <ul style="list-style-type: none"> Engagement on whether PFFI has been compiled, on basis of applicable involves performing procedures, to assess whether applicable criteria used provide a reasonable basis & to obtain sufficient appropriate evidence about whether :- Pro forma adjustments give appropriate effect PFFI reflects proper application of those adjustments Procedures selected depend on his understanding of entity event/txn. other circumstance Engagement also involves evaluating overall presentation of PFFI
8	Practitioner's opinion using one of the phrases :- <ol style="list-style-type: none"> PFFI has been compiled, in all material respects, on basis of applicable criteria or PFFI has been properly compiled on basis stated.
9	EOM para (if he consider necessary to draw user's attention to a matter)
10	Practitioner's signature
11	Date of report &
12	Place of signature.